INTRODUCTION

The term ‘TRANSFER PRICING’ refers to the process by which related entities set up the prices at which they transfer goods and services between each other.

Transfer pricing between related parties in different tax jurisdictions has become a major issue for revenue collectors due to the varying corporate tax rates applied across such parties. Techniques used by multinational corporations to manipulate their taxable income across jurisdictions result in huge losses in domestic tax revenue for many countries.

This is particularly prevalent when dealing with intangible property, due to the difficulty and disagreement in attributing exact values and royalty rates to intangible property and the ease at which such values can be manipulated.

Transfer pricing control therefore refers to the mechanisms employed by revenue collectors to curb such pricing manipulation.
1. SOUTH AFRICA

1.1. In South Africa, such issues are dealt with by the South African Revenue Service (SARS) in accordance with section 31 of the Income Tax Act, 1962, introduced in 1995, which is based on the transfer pricing provisions provided by the Organisation for Economic Co-Operation and Development (the OECD).

1.2. According to the OECD guidelines on transfer pricing (the principles of which have been largely adopted into section 31 of the Income Tax Act) the main requirement is to ensure that a transaction is concluded at arm’s length and that the transfer pricing between group entities is also at arm's length (also known as the ‘arm’s length principle’). The OECD guidelines prescribe methodologies for determining arm’s length pricing which have been adopted by many countries for their local transfer pricing regulation.

1.3. SARS controls transfer pricing through section 31 by enabling the Commissioner of SARS to adjust the price charged between multinational entities (where one of those entities is a tax resident) which are different to what would have been concluded at an arm’s length basis between unrelated persons and to tax the entity concerned according to the adjustment, as well as raise penalties and interest.

1.4. Section 31 is applied as follows: Where any transaction, operation, scheme, agreement or understanding constitutes an affected transaction and any term or condition thereof results or will result in a tax benefit for a party to that transaction, the taxable income of that person must be calculated as if that transaction had been entered into in arm’s length dealing.

1.5. In order to do this an international model of the arm’s length principle, as set out in the OECD guidelines, has been adopted. SARS promotes the use of the OECD guidelines for such a purpose and prescribes that these guidelines are to be used in interpreting what an arm’s length transfer price is in South Africa.
2. SOUTH AFRICA: IMPORTANT CONCEPTS

2.1. An ‘AFFECTED TRANSACTION’ is any transaction, operation, scheme, agreement or understanding that is entered into directly or indirectly for the benefit of either or both:
   - a resident and a non-resident;
   - a non-resident and another non-resident that has a permanent establishment in South Africa to which the transaction, operation, scheme, agreement or understanding relates;
   - a resident and another resident that has a permanent establishment outside of South Africa to which the transaction, operation, scheme, agreement or understanding relates;
   - a non-resident and a controlled foreign company in relation to any resident and the persons are connected persons.

2.2. The meaning of ‘CONNECTED PERSON’ is distinguished in relation to four different types of persons, being a natural person, a trust, a company and a close corporation as follows:

2.2.1 in relation to a NATURAL PERSON, this is:
   - any relative;
   - any trust (other than a portfolio of a collective investment scheme in securities or in property)

2.2.2 in relation to a TRUST (other than a portfolio of a collective investment scheme in securities or in property), this is:
   - any beneficiary of such trust;
   - any connected person in relation to such beneficiary

2.2.3 in relation to a COMPANY, this is:
   - any other company that is part of the same group of companies;
   - any person other than a company as defined in section 1 of the Companies Act, 2008 who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20% of the equity shares of voting rights in the company;
   - any other company if such company is managed or controlled by any person that is a connected person in relation to such company or any person that is a connected person in relation to the first mentioned person;
in relation to a **CLOSE CORPORATION**:

– any member;
– any relative of such member or any trust (other than a portfolio of a collective investment scheme in securities or in property) that is a connected person in relation to such member;
– any other close corporation or company that is a connected person in relation to any member of the close corporation, or the relative or trust as contemplated above.

**2.3.** A ‘**TAX BENEFIT**’ is defined in section 1 as including any tax avoidance, postponement or reduction of any liability for tax.

### 3. BASE EROSION AND PROFIT SHIFTING (BEPS)

**3.1.** Base erosion and profit shifting (BEPS) refers to tax outcomes that result in double non-taxation or reducing the tax base in high tax jurisdictions. Many jurisdictions have experienced that BEPS outcomes are difficult to regulate by way of unilateral actions by countries individually and a multinational approach was needed. The G20\(^1\) countries requested that the OECD provide an international solution to this, which resulted in the OECD BEPS Action Plan (the **Action Plan**).

**3.2.** The Action Plan was first published in 2013 in order to address issues and flaws in international tax rules. The Final Action Plan was published in October 2015 and contains 15 separate action points with the goal of harmonising international tax and transfer pricing rules, and ensuring that profits are taxed where economic value is being created.

**3.3.** Importantly, actions 8 to 10 of the 2015 BEPS Final Report contain specific provisions for the aligning transfer pricing outcomes with value creation. Transfer pricing issues dealt with include transactions involving intangibles; contractual arrangements, including the contractual allocation of risks and corresponding profits and other high-risk areas.

**3.4.** The OECD BEPS project comes with strong international political support and significant changes in respect of international taxation in accordance with the report should be expected. As the report set its sights on transfer pricing as a key issue, it is very important to stay abreast of the developments any potential international taxation changes which lay ahead, including new compliance requirements such as country-by-country reporting for large multinationals.

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\(^1\) Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, the USA.
4. TRANSFER PRICING IN AFRICA

4.1 There has been significant debate in respect of the most appropriate transfer pricing regime for countries in Africa. This is largely as the sophistication of the revenue authorities in Africa vary and there are a number of unique challenges faced by African countries.

4.2 A number of African countries, including Kenya, Egypt, Morocco and South Africa, have broad and robust transfer pricing systems which accord with the OECD guidelines. A number of other countries, such as Burkina Faso, Ghana, Cameroon, and Gabon have transfer pricing legislation based on the OECD documentation requirements.

4.3 Transfer pricing control is becoming increasingly important for African nations and is quickly becoming a priority area in the protection of local tax bases.

4.4 The African Tax Administration Forum (ATAF) was created in November 2009 with the aim to increasing voluntary tax compliance and curbing tax evasion and avoidance, with 37 African member states as at 2015. It has noted since its inception that there is an urgent need in Africa to develop the capacity of member countries in the area of transfer pricing.

4.5 In addition, the United Nations began an effort in 2009 to assist developing countries on how to draft transfer pricing legislation, how to set up specialised transfer pricing units and how to identify and work with transfer pricing databases and how to pursue simplified strategies for testing the arm’s length nature of related party transactions.

4.6 Together these efforts, along with the efforts of the OECD and the individual states, will result in critical changes in the African landscape and any cross-border multinational with a presence in Africa will need to stay abreast of the rapid developments and the nuances of the African transfer pricing regimes.
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As a leading intellectual property firm with a strong and dynamic commercial practice, Adams & Adams is strategically placed and well-versed in the legal consequences of transfer pricing in Africa and abroad and have assisted numerous clients in navigating the African transfer pricing landscape. With experienced commercial and tax attorneys, intellectual property practitioners and transfer pricing litigators and a wealth of knowledge and resources in the valuation of intangibles and the defending of assessment documentation, Adams and Adams can play a vital role in assisting any corporate to meet its transfer pricing compliance requirements.

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